

**Department of Commerce and Insurance**  
**For the Years Ended**  
**June 30, 1999, and June 30, 1998**

**Arthur A. Hayes, Jr., CPA, JD, CFE**

Director

**Financial & Compliance**

**Charles K. Bridges,  
CPA**

Assistant Director

**Elizabeth M. Birchett, CPA**

Audit Manager

**Sandra McSeveney, CPA**

In-Charge Auditor

**Bridget Carver**

**Jason Conner**

**Danisha Jones**

**Julianna Spears**

**Brad Truitt**

Staff Auditors

**Investigations**

**Glen McKay, CIA, CFE**

Assistant Director

**Chas Taplin, CPA, CFE**

Audit Manager

**Shay Smith, JD, CFE**

**Trey King**

Staff Auditors

**Amy Brack**

Editor

Comptroller of the Treasury, Division of State Audit  
1500 James K. Polk Building, Nashville, TN 37243-0264  
(615) 741-3697

Financial/compliance audits of state departments and agencies are available on-line at  
[www.comptroller.state.tn.us/sa/reports/index.html](http://www.comptroller.state.tn.us/sa/reports/index.html).

For more information about the Comptroller of the Treasury, please visit our Web site at  
[www.comptroller.state.tn.us](http://www.comptroller.state.tn.us).



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

**John G. Morgan**  
Comptroller

October 20, 2000

The Honorable Don Sundquist, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243  
and  
The Honorable Anne B. Pope, Commissioner  
Department of Commerce and Insurance  
Fifth Floor, Davy Crockett Tower  
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Commerce and Insurance for the years ended June 30, 1999, and June 30, 1998.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Commerce and Insurance's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Commerce and Insurance is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal controls and/or instances of noncompliance to the Department of Commerce and Insurance's management in a separate letter.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

JGM/mb  
00/056

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Department of Commerce and Insurance**  
For the Years Ended June 30, 1999, and June 30, 1998

---

## AUDIT SCOPE

We have audited the Department of Commerce and Insurance for the period July 1, 1997, through June 30, 1999. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of inaction on the part of an insurance division employee involved in the regulation of Franklin American Life Insurance Company—Special Investigation; Regulatory Boards; Modular Housing; Manufactured Housing; Motor Vehicle Commission; Consumer Affairs; Annual Report; Arson; Insurance; TennCare Oversight; Travel; Contracts; Board of Accountancy; and compliance with the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

## AUDIT FINDINGS

### **Examination Procedures Were Not Followed and Additional Procedures Are Needed**

In 1993, examiners did not properly verify the securities of Franklin American Life Insurance Company. The examiners' failure to note the lack of a safekeeping agreement, in regard to those securities, extended the period of a fraudulent scheme involving the insurance company's securities (page 5).

### **Desk Examinations Need Improvement and Additional Procedures**

The desk examinations performed on annual and quarterly financial statements of Franklin American Life Insurance Company

did not raise appropriate questions regarding the company's unusual volume of trades and reported returns on its investments (page 7).

### **“Target Examination” Procedures Were Not Followed**

None of the work performed by insurance division staff on its 1996 target examination of Franklin American Life Insurance Company was documented as required (page 9).

### **Documentation Department-wide Needs Improvement**

Reviews of acquisition and merger forms; meetings, telephone calls, and other correspondence; and the reasons for the

department to place Franklin American Life Insurance Company in administrative supervision were not documented (page 11).

#### **Need to Have Written Procedures for the Regulatory Board Annual Report**

The Division of Regulatory Boards does not have written documentation of the procedures employed to produce the annual report of each board's fees collected, expenditures, and reserve balances (page 13).

#### **Need to Improve Monitoring of Modular Housing Compliance With Codes**

The Codes Enforcement section of the Division of Fire Prevention is not adequately monitoring compliance with modular housing policies and procedures (page 15).

#### **Documentation of Manufactured Housing Inspections Is Insufficient**

The Codes Enforcement section of the Division of Fire Prevention is not enforcing federal and state policies and procedures for

documentation of manufactured housing inspections (page 17).

#### **Motor Vehicle Commission Policies Do Not Comply With State Law**

The commission's policies and procedures make an unauthorized exception to state law when issuing motor vehicle dealership licenses in some counties (page 20).

#### **Consumer Affairs Division Should Improve Complaint Follow-up Time**

The division is not sending letters to respondents within the time frame specified in its policies and procedures for following up consumer complaints (page 22).

#### **The Annual Report to the Governor Should Be Issued in Compliance With State Law**

The department's annual report is not issued in the manner prescribed by state law (page 23).

---

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit  
1500 James K. Polk Building, Nashville, TN 37243-0264  
(615) 741-3697

Financial/compliance audits of state departments and agencies are available on-line at  
[www.comptroller.state.tn.us/sa/reports/index.html](http://www.comptroller.state.tn.us/sa/reports/index.html).

For more information about the Comptroller of the Treasury, please visit our Web site at  
[www.comptroller.state.tn.us](http://www.comptroller.state.tn.us).

---

**Audit Report**  
**Department of Commerce and Insurance**  
**For the Years Ended June 30, 1999, and June 30, 1998**

---

**TABLE OF CONTENTS**

---

	<u>Page</u>
<b>INTRODUCTION</b>	1
Post-Audit Authority	1
Background	1
<b>AUDIT SCOPE</b>	4
<b>OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS</b>	4
Inaction on the Part of an Insurance Division Employee Involved in the Regulation of Franklin American Life Insurance Company—Special Investigation	4
Finding 1—Examination procedures were not followed and additional procedures are needed	5
Finding 2—Desk examinations need improvement and additional procedures	7
Finding 3—“Target examination” procedures were not followed	9
Finding 4—Documentation department-wide needs improvement	11
Regulatory Boards	12
Finding 5—The Division of Regulatory Boards does not have written policies and procedures for the preparation of the annual report	13
Modular Housing	14
Finding 6—Codes Enforcement is not monitoring compliance with modular housing policies and procedures	15
Manufactured Housing	16
Finding 7—There is insufficient documentation of manufactured housing inspections to determine compliance with regulations	17
Motor Vehicle Commission	19
Finding 8—The Motor Vehicle Commission’s policies are not in compliance with state law	20

---

## TABLE OF CONTENTS (CONT.)

---

	<u>Page</u>
Consumer Affairs	21
Finding 9–The Division of Consumer Affairs does not comply with its procedures for timely follow-up with complaint respondents	22
Annual Report	23
Finding 10–The department did not submit its annual report in compliance with state law	23
Arson	24
Insurance	24
TennCare Oversight	25
Travel	25
Contracts	26
Board of Accountancy	26
Financial Integrity Act	26
<b>PRIOR AUDIT FINDINGS</b>	27
<b>OBSERVATIONS AND COMMENTS</b>	28
Title VI of the Civil Rights Act of 1964	28
Title IX of the Education Amendments of 1972	28
<b>APPENDIX</b>	29
Divisions and Allotment Codes	29

# **Department of Commerce and Insurance**

## **For the Years Ended June 30, 1999, and June 30, 1998**

---

### **INTRODUCTION**

---

#### **POST-AUDIT AUTHORITY**

This is the report on the financial and compliance audit of the Department of Commerce and Insurance. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

#### **BACKGROUND**

The Department of Commerce and Insurance was established to protect the public health and safety of Tennessee’s citizens. The mission of the department is to provide the leadership and support necessary to protect the public health and safety by

- maintaining public confidence in the integrity of the consumer and financial service industries and professions;
- safeguarding consumers from deceptive business practices;
- ensuring a fair and competitive marketplace in which businesses have the flexibility to operate in order to promote economic and community development within the state;
- requiring adherence to certain recognized and established standards of conduct in consumer and financial service industries and professions; and
- protecting life and property through fire prevention, education, investigation and enforcement, and access to enhanced emergency communications.

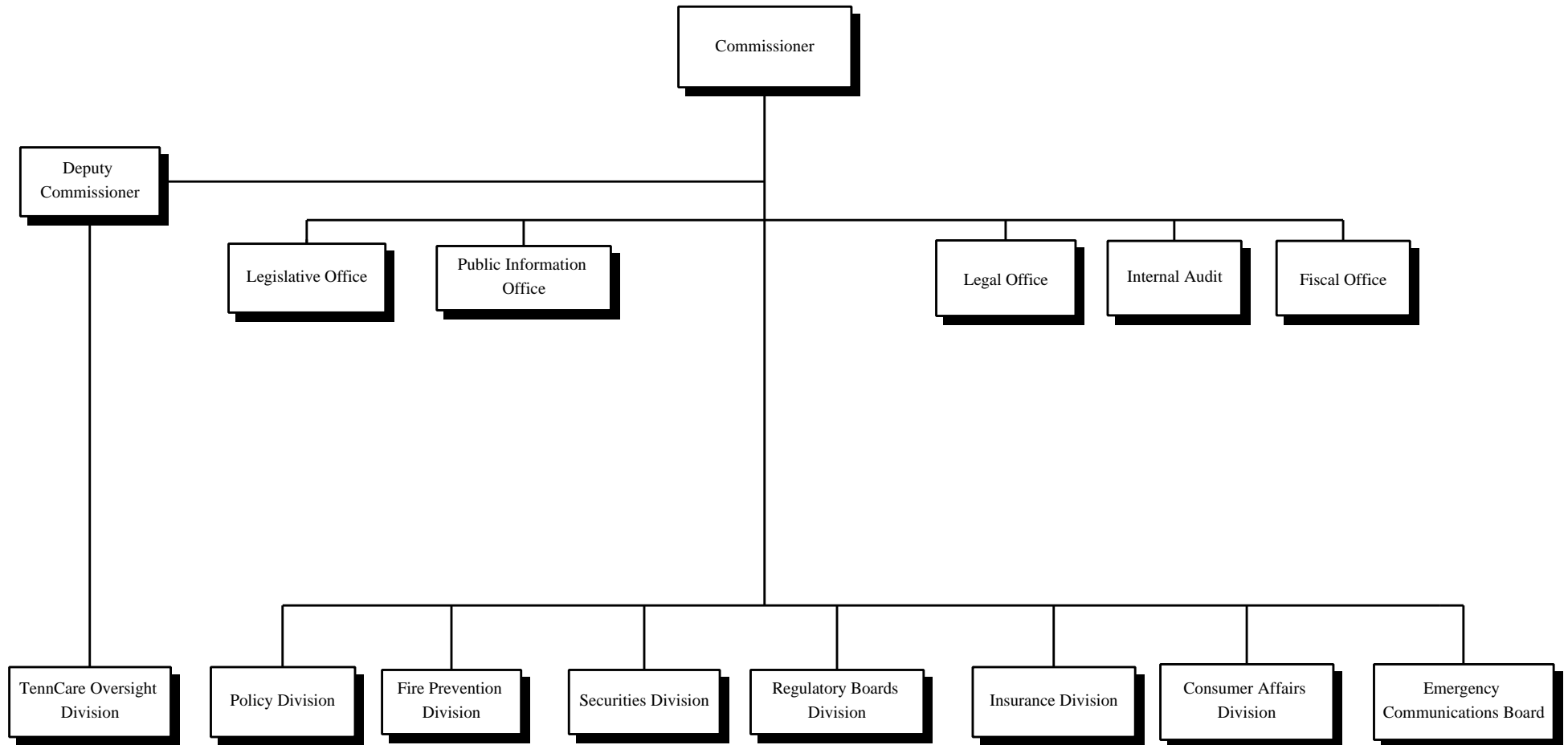
All programs support the central mission of the department and have a direct impact on the physical and financial health, education, and public safety of Tennessee’s citizens. The following are the department’s seven major programs:



- **Consumer Affairs**—Protects consumers from deceptive business practices through complaint mediation, consumer education, investigations, and formal actions.
- **Emergency Communications Board**—Protects the public through implementation of statewide enhanced 911 service for land and wireless lines.
- **Fire Prevention**—Protects life and property through fire prevention, education, investigations, and enforcement.
- **Insurance**—Protects the public through oversight and administration of insurance statutes to ensure the financial integrity of companies operating in the state and ensure that companies and agents are acting in compliance with the state law.
- **Regulatory Boards**—Protects the health and safety of citizens through boards and commissions, by ensuring that persons meet minimum professional standards, by responsively and timely handling complaints, and by providing consumer education on regulated professions and industries.
- **Securities**—Protects investors by enforcing the Tennessee Securities Act of 1980 and by maintaining the integrity of the securities market.
- **TennCare Oversight**—Protects the public health and integrity of the TennCare Program by overseeing, examining, and monitoring MCOs participating in the program.

An organization chart of the department is on the following page.

# DEPARTMENT OF COMMERCE AND INSURANCE ORGANIZATION CHART



---

## AUDIT SCOPE

---

We have audited the Department of Commerce and Insurance for the period July 1, 1997, through June 30, 1999. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of inaction on the part of an insurance division employee involved in the regulation of Franklin American Life Insurance Company (Special Investigation); Regulatory Boards; Modular Housing; Manufactured Housing; Motor Vehicle Commission; Consumer Affairs; Annual Report; Arson; Insurance; TennCare Oversight; Travel; Contracts; Board of Accountancy; and compliance with the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

---

## OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

---

### **INACTION ON THE PART OF AN INSURANCE DIVISION EMPLOYEE INVOLVED IN THE REGULATION OF FRANKLIN AMERICAN LIFE INSURANCE COMPANY—SPECIAL INVESTIGATION**

This review was initiated in July 1999 after information was received by this office from State of Tennessee officials and the national news media. In May 1999, it was reported in the news media that Mr. Martin R. Frankel, an unlicensed securities broker from Greenwich, Connecticut, had disappeared after allegedly stealing \$200 million in funds of Franklin American Life Insurance Company and other related corporate entities. These companies invested their reserves with Liberty National Securities, Inc., a brokerage firm he anonymously controlled. The information received by the Division of State Audit alleged that prior to May 1999, state regulators within the Tennessee Department of Commerce and Insurance failed to appropriately react to significant warning signs and information available to them regarding Franklin American Life Insurance Company and Liberty National Securities, Inc.

The objectives of our review were

- to determine whether the department was in compliance with state statutes and national regulations and guidelines in the examinations and financial analyses of Franklin American Life Insurance Company;
- to determine whether the department followed state and federal statutes in regard to the approval of the acquisitions of the company and Franklin American Corporation by Thunor Trust;
- to determine whether reasonable actions were taken on the part of department officials in the regulation of the company;

- to evaluate whether the department gave special treatment to the company;
- to identify any weaknesses in the department's internal controls over the examinations and analyses of Franklin American Life Insurance Company;
- to report our findings to the department and recommend appropriate actions to correct any deficiencies; and
- to report our findings to the Office of the State Attorney General, the United States General Accounting Office (GAO), the Federal Bureau of Investigation (FBI), and the general public.

On July 2, 1999, Division of State Audit staff took possession of original documents relating to Franklin American Life Insurance Company, Franklin American Corporation, Thunor Trust, and Liberty National Securities, Inc., maintained by the Department of Commerce and Insurance. Copies of the documents in possession of the department's legal staff were subsequently obtained. Our review included an examination of the department's documents. We also interviewed current and former staff of the department's insurance division, securities division, legal office, and the Commissioner's office.

Based on our interviews and review of supporting documentation of the insurance division's regulation of Franklin American Life Insurance Company, the insurance division's internal controls were not adequate. Specifically, examination procedures were not followed and additional procedures are needed, desk examinations need improvement and additional procedures, and "target examination" procedures were not followed. Furthermore, documentation department-wide needs improvement.

# **1. Examination procedures were not followed and additional procedures are needed**

## **Finding**

During the insurance division's examination of Franklin American Life Insurance Company in 1993, the examiners did not properly follow examination procedures regarding the verification of securities. The *Financial Condition Examiners Handbook* requires examiners to determine whether a custodial or safekeeping agreement with a bank or trust company was in place regarding the securities of the insurance company under examination. State Audit's review of the regulation of Franklin American Life Insurance Company revealed that the examiners accepted confirmations from Liberty National Securities, Inc., regarding the insurance company's reserves allegedly invested at the brokerage firm. Although the examination work papers for 1993 were destroyed pursuant to department practice, it is clear that a custodial agreement was not in place, yet the lack of such an agreement was not mentioned in the examination report issued in 1993. In addition, the insurance division, at that time, did not have a procedure requiring a supervisory review of examination work papers. However, the division has since adopted the National Association of Insurance Commissioners (NAIC) procedures, which include a supervisory review.

Furthermore, the examiners were not required by examination procedures to consult with the securities division regarding the status, viability, and registration of a brokerage firm allegedly trading the insurance company's investments.

The failure of the examiners to follow the established examination procedures and accepting confirmations from the brokerage firm resulted in extending the period that a fraudulent scheme, involving the insurance company's securities, went undetected. Additionally, the destruction of work papers for troubled insurance companies prohibits their proper review at a subsequent date, as was the case with Franklin American Life Insurance Company.

### **Recommendation**

Policies and procedures relative to the requirements that assets be held in a custodial bank pursuant to a custodial agreement should be followed. Additional policies and procedures should be promulgated to address confirmations, documentation, and supervisory review and signoffs. If assets are held or traded by a securities brokerage firm, the status and viability of the firm should be confirmed with the securities division. In addition, the Division of Insurance should determine the appropriate retention period for examination working papers. If the examination addresses a troubled company, the working papers should not be discarded under any circumstances. The department should consider appropriate disciplinary actions relating to the apparent lack of due diligence on the part of the various department staff.

### **Management's Comment**

We concur. The Insurance Division has issued Policy Statement #1 with an effective date of March 8, 2000, clearly delineating the procedure for confirmation of securities to include written confirmation of the status of the custodian bank, documentation of the assets and where they are held, reporting to supervisory staff, and documentation of supervisory review. Additionally, procedures contained within the policy statement are enumerated for both examination and financial analysis to ensure that adequate scrutiny is given to investment activity. This policy was distributed to all examination and financial analysis staff and was implemented immediately upon issuance. On March 8, 2000, a memo was forwarded to the Chief of Fiscal Services from the Assistant Commissioner of Insurance requesting an amendment to Records Disposition Authority #2227 governing the destruction of examination workpapers. This memo requests that the amended Records Disposition Authority read as follows:

Workpapers will be maintained in the office for a minimum of five years until the release of the next examination; at which point workpapers may be maintained either in the agency or in the records management center for an additional five years. Once the next subsequent report is issued, workpapers may be destroyed by an approved method after authorized in writing by the Assistant Commissioner for Insurance. For those companies with ongoing regulatory compliance and/or financial problems, examination workpapers shall

be retained until said company has cured its regulatory deficiency and has maintained substantial compliance for a period of at least five years.

As noted in the finding, part of the failure resulted from inadequate procedures which the department has addressed. As recommended, management is considering additional appropriate corrective actions within the Insurance Division to ensure compliance with established laws, rules, and policies.

Due to the implementation of these and other enhanced procedures, the department is in the process of determining whether additional resources will be necessary.

## **2. Desk examinations need improvement and additional procedures**

### **Finding**

In the desk examinations (analytical reviews) of annual and quarterly financial statements of Franklin American Life Insurance Company by the insurance division, the procedures did not require the analysts to consider asset turnover. The unusual volume of trading and reported 20 percent return on investments for 1993 by the company should have raised additional questions during the review by the analysts. This unusual volume of trading (high asset turnover) continued to be reported by the company through 1998. If reasonable and understandable answers are not obtained from company officials, such a situation should prompt the use of an expert or prompt a properly targeted examination. Additionally, questions on investments, securities, and trading strategies should prompt insurance division staff to consult with the securities division. Furthermore, financial analyst supervisors were not required to confirm critical checklist items with the supporting documentation. In the desk examinations of the annual financial statements of Franklin American Life Insurance Company, reviews by analysts were conducted incorrectly. These errors were not detected because checklist items regarding the company's control of its assets were not properly reviewed by supervisors.

The lack of appropriate procedures and the lack of due diligence on the part of the insurance division staff to understand the reported financial activities of Franklin American Life Insurance Company resulted in extending the period that a fraudulent scheme, involving the insurance company's securities, went undetected.

### **Recommendation**

To ensure that unusually high trading activities are properly noted and reviewed, ratio and benchmark indicators for asset turnover need to be developed. Additionally, critical checklist items should be specified. Financial analyst supervisors should be required to confirm these critical checklist items with supporting documentation and to signify their confirmations with signoffs and dates. All materials received from or sent to companies should be date-stamped. All reviewers should be required to initial and date their reviews. Furthermore, the department

should consider appropriate disciplinary actions relating to the lack of due diligence on the part of the various department staff.

### **Management's Comment**

We concur. A memorandum dated March 8, 2000, was issued by the Assistant Commissioner for Insurance to the Director of Financial Analysis, the Chief Examiner, and the Chief Analyst addressing items deemed critical and requiring enhanced, documented supervisory review. The following items were stipulated as requiring extensive supervisory review:

- Capital and Surplus – Ascertain that capital and/or surplus meet statutory requirements.
- Net Income/Losses – Review net income/loss for the current year as well as the preceding two years to ascertain whether a trend of declining profitability and potential net worth impairment appears imminent.
- General Interrogatories – Review all general interrogatories included in the review checklist to ensure that information on the checklist has been recorded correctly and poses no indication of noncompliance with state law. These interrogatories include, but are not limited to, questions regarding the custody of investments, changes in the corporate charter, by-laws, or articles of the corporation, conflicts of interest of corporate officials, reinsurance contracts, and contingent liabilities.
- Computed Ratios on Asset Turnover and Liquidity – Ratios are to be recomputed in accordance with the formula included in the checklist to determine whether the ratios are in excess of the established benchmarks. Asset turnover should be no more than one time per year and liquidity should range between 1:1 and 1:1.5.
- Actuarial Opinion – The checklist is to be compared to the actuarial opinion to ensure that the checklist is completed properly and that deficiencies in the opinion have been identified. Particular attention is to be given to questions relevant to the qualifications of the actuary, opinion elements, the actuary's expression of opinion, and concerns that may be expressed regarding surplus relief insurance.

To ensure that this enhanced review is adequately documented, the annual statement review checklists for life and health companies and property and casualty companies were revised and implemented in the review of the 1999 annual statements for all Tennessee domestic companies. Additionally, a form was developed and implemented to document the deficiencies noted in the review by the supervisor and the corrective actions taken by the analyst performing the review on said deficiencies.

It is the practice of the Insurance Division to date stamp all materials received within the division; however, to ensure that this procedure was adequately communicated, a memorandum dated March 8, 2000, was distributed to all divisional staff emphasizing the importance of date stamping documents.

As noted in the finding, part of the failure resulted from inadequate procedures which the department has addressed. As recommended, management is considering additional appropriate corrective actions within the Insurance Division to ensure compliance with established laws, rules, and policies.

Due to the implementation of these and other enhanced procedures, the department is in the process of determining whether additional resources will be necessary.

### **3. “Target examination” procedures were not followed**

#### **Finding**

The insurance division did not document the work it performed in regard to the 1996 target examination of Franklin American Life Insurance Company as required by the *NAIC Examiners Handbook*. After a one-day on-site review of a limited number of trading confirmations and monthly statements from the brokerage firm allegedly investing the company's funds, two analysts reported their inconclusive findings verbally to the insurance division director. No documentation was found in regard to the target examination. The *NAIC Examiners Handbook* states that such reports should describe, at a minimum, the limited objective of the examination, the overall scope of procedures applied, and the examiner's findings from performing those procedures. Additionally, management of the insurance division failed to ensure that target examination procedures were followed.

Furthermore, after the analysts failed to obtain answers regarding the unusual trading strategy during the target examination, they recommended that the insurance division management hire a securities expert to pursue these outstanding issues. However, the insurance division management did not consult with the other divisions of the department and waited nearly two years before an expert was hired. The insurance division's management's inaction resulted in extending the period that a fraudulent scheme, involving the insurance company's securities, went undetected.

#### **Recommendation**

Target examinations should be documented to include planning, objectives, scope, findings, and conclusions. Supervisory review of target examinations should also be documented by signoffs and dates. All meetings, telephone calls, letters, and e-mails with companies should be documented, and these communications should be maintained in insurance company files.

In addition, insurance division staff should consider attending training in regard to securities and investments. Furthermore, the department should consider appropriate disciplinary actions relating to the inactions and the apparent lack of due diligence on the part of the various department staff.



Moreover, the Division of Insurance should develop policies and procedures requiring staff to promptly notify top management, the department's legal section, and other divisions regarding any indications of fraud, abuse, or illegal acts.

### **Management's Comment**

We concur. In accordance with state law governing examinations of insurance companies, Policy Statement #3 was issued with an immediate effective date to the Chief Examiner by the Assistant Commissioner for Insurance on March 8, 2000, stipulating the procedures for the performance and documentation of target examinations. The procedures delineated within this policy state:

- Once information has been received that necessitates a target examination by the division, a Certificate of Authority should be prepared by the Chief Counsel for Insurance for the Commissioner's signature. This Certificate of Authority should include information regarding the purpose and scope of the examination. If the purpose is a potential or actual violation of state law, the purpose should be documented with a statutory reference. The period reviewed, the personnel assigned, and the date of the examination commencement should also be included as required information in the Certificate of Authority.
- Once the target examination has begun, periodic written updates must be received from the on-site examiner. These updates may be as frequent as required by the Chief Examiner based on the facts ascertained by the on-site examiner.
- Once the examination is completed, an examination report must be prepared by the on-site examiner and submitted to the Chief Examiner for review. After review, the Chief Examiner must submit to the Director of Financial Analysis, the Assistant Commissioner for Insurance, and the Chief Counsel for Insurance for additional review and approval for finalization.
- If the on-site examiner discovers any indication of fraud, abuse, or illegal acts at any time during the target examination, said information must be immediately reported, in writing, to the Chief Examiner. Once received by the Chief Examiner, the report shall be immediately submitted to the Director of Financial Analysis, the Assistant Commissioner for Insurance, the Chief Counsel for Insurance, and the Commissioner for the Department of Commerce and Insurance. This submission should be clearly designated as high priority and measures must be taken to ensure that the information is communicated to the aforementioned departmental officials.

- This policy is in effect until amended or rescinded by the Assistant Commissioner for Insurance.

Additionally, the Office of Audit and Consulting Services has consulted with the Examinations Section and has assisted in developing an appropriate reporting format for target examinations including planning, objectives, scope, findings, and conclusions.

To aid the department in its ability to employ experienced contract examiners to conduct both target and routine examinations, legislation was proposed by the department and passed during the most recent legislative session to increase the compensation paid to contract examiners. Public Chapter 642, effective April 10, 2000, will facilitate the department in employing examiners with specialized knowledge when particularly complex issues arise during an examination or when target examinations are needed to address problems arising prior to an insurer's routine examination.

Policy Statement #4 was issued to all Examinations Section Staff on March 8, 2000, from the Assistant Commissioner for Insurance. This policy addresses the documentation of and procedures for reporting indications of fraud, abuse, or illegal acts by an insurer. The policy further defines fraud, abuse, and illegal acts and clearly stipulates that any indication of these occurrences is to be reported to the Chief Examiner, the Director of Financial Analysis, the Assistant Commissioner for Insurance, the Chief Counsel for the Insurance Division, and the Commissioner for the Department of Commerce and Insurance. Although the guidelines in the NAIC Financial Examiner's Handbook remain silent in addressing fraudulent activity by an insurer, information compiled by the department's Office of Audit and Consulting Services regarding potential indicators of fraud was distributed to the Chief Examiner on April 14, 2000, for distribution to all Examination Section Staff as a guideline for use in field examinations.

Part of the department's failure resulted from a misinterpretation regarding appropriate target examination procedures. The department is clarifying and correcting this interpretation. As recommended, management is also considering additional appropriate corrective actions within the Insurance Division to ensure compliance with established laws, rules, and policies.

Due to the implementation of these and other enhanced procedures, the department is in the process of determining whether additional resources will be necessary.

#### **4. Documentation department-wide needs improvement**

##### **Finding**

The Insurance and Legal division reviews of acquisition and merger forms for Franklin American Life Insurance Company were not maintained in the insurance company files if they were documented originally in 1991. Additionally, documentation of meetings, telephone calls, and other correspondence between department and company officials was not maintained. Furthermore, the decision to place Franklin American Life Insurance Company in administrative

supervision was not documented in the insurance company files. The lack of documentation of reviews, communications, and decisions limits management's ability to support their actions and their ability to perform subsequent reviews related to these events.

### **Recommendation**

Insurance and Legal Division reviews of acquisition and merger forms should be documented and maintained in insurance company files. All meetings, telephone calls, letters, and e-mails with companies should be documented, and these communications should be maintained in insurance company files.

Furthermore, decisions regarding sanctions against insurers and any subsequent removals of sanctions should be documented and maintained in insurance company files.

### **Management's Comment**

We concur. On March 8, 2000, Policy Statement #5 was issued to address the appropriate procedures for maintaining documentation and approval of mergers. The primary purpose of this policy is to ensure that all documentation associated with a merger or acquisition affecting a Tennessee domiciled insurer is properly reviewed, transmitted, and approved in accordance with state law and departmental rules and regulations. The policy procedures clearly delineate the process for review, the documentation required, and the levels of review required. All information is to be maintained in the individual insurance company file. Policy Statement #2 addressing the documentation of meetings with insurance companies and the retention of meeting documentation was issued with an effective date of March 8, 2000, and requires that notes of the meeting activities be taken, transcribed, and maintained in the company's file. Additionally, Policy Statement #6 was issued on March 8, 2000, setting forth the appropriate procedures for documenting regulatory actions taken against an insurer.

Due to the implementation of these and other enhanced procedures, the department is in the process of determining whether additional resources will be necessary.

---

## **REGULATORY BOARDS**

The objectives of our review of the controls and procedures in the Division of Regulatory Boards were to determine whether

- revenue collection, accounting, and reconciliation procedures are consistent throughout the division;
- adequate procedures for the preparation of the annual report for regulatory boards have been established; and

- the procedures for preparation of the annual report are followed.

We interviewed key personnel to gain an understanding of the division's procedures for and controls over regulatory board recording of fees and reporting of revenues, expenses, and reserve balances in the annual report. We reviewed supporting documentation for the 1999 annual report to determine if existing procedures resulted in an accurate presentation of the year's activity and ending balance. In addition, we performed testwork on samples of expenditures, revenues, and payroll transactions.

We determined that procedures for the preparation of the annual report of regulatory board fees should be formally documented, as discussed in finding 5.

## **5. The Division of Regulatory Boards does not have written policies and procedures for the preparation of the annual report**

### **Finding**

Each of the regulatory boards in the division is required to be self-sufficient. The division compiles an annual report detailing each regulatory board's license and fee collections, expenditures, and beginning and ending reserve balances. The legislature uses this report to determine if each board is self-sufficient and to adjust the fees of those boards that appear to be collecting too much or too little to cover expenses. In addition, reserve balances in this report appear in notes to the state's annual financial statements.

The division obtains all revenue and expenditure amounts for the report from the state's accounting system. Indirect costs, consisting of department administration, division administration, legal, and investigation expenditures, are allocated among the several boards.

Although the report was prepared using reasonable procedures and reflecting information in the state's accounting system, the division has not documented the procedures in use. It is important these activities be formalized in a procedures manual to provide

- a guide—to serve as a checklist—to ensure that all appropriate data is gathered and accurately presented,
- documentation of sources of data presented in the report,
- documentation of indirect cost allocation methodology,
- documentation of unusual or nonrecurring circumstances,
- year-to-year consistency, and
- a working plan for staff in future years when the originators of these procedures might no longer be preparing this report.

In addition, an error of omission occurred in the preparation of the 1999 report, resulting in a \$412,972 understatement of expenditures and overstatement of the ending reserve balance. Because the omitted item was an indirect cost that should have been allocated among the boards, each board's expenditures and ending reserve balance were similarly affected. There is no evidence of fiscal office review of this report. Such a review should have made the omission apparent.

### **Recommendation**

The division should develop a formal written set of procedures for the preparation of the annual report in order to ensure accurate and complete reporting of regulatory board fee collections, expenditures, and reserve balances. The procedures should provide a description of the sources of all data; documentation of the allocation methods for the various indirect costs; the system for compilation of amounts, by board, for presentation in the report; and effective review by the department's fiscal office.

### **Management's Comment**

We concur. The Administration Office of the Division of Regulatory Boards is in the process of developing a Standard Office Procedures Manual to identify and explain how to complete each step in the preparation of the annual report. After completion of the annual report it will be forwarded to the Department's Fiscal Office for approval prior to it being sent to the Commissioner of Finance and Administration.

---

## **MODULAR HOUSING**

The objectives of our review of the modular housing controls and procedures in the Codes Enforcement section of the Division of Fire Prevention were to determine the adequacy of the procedures to carry out the section's responsibilities for modular housing and whether the section follows its procedures.

We reviewed applicable laws and regulations to determine the Codes Enforcement section's responsibilities for modular housing. We interviewed key personnel to gain an understanding of the section's controls and procedures for modular housing, and we reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of construction inspection agencies and modular housing manufacturers for calendar years 1998 and 1999.

We determined that Codes Enforcement is not monitoring compliance with the division's modular housing policies and procedures, as discussed in finding 6.

**6. Codes Enforcement is not monitoring compliance with modular housing policies and procedures**

**Finding**

The file for one of five construction inspection agencies tested (20%) did not have 15 of the required 24 monthly inspection reports for 1998 and 1999, nor was there any documentation of follow-up requests for these late and missing reports. Section 68-126-304 (2), *Tennessee Code Annotated*, requires inspections of modular building units at the place of manufacture and gives authority to the Commerce and Insurance Commissioner to approve construction inspection agencies to perform these inspections. In its Modular Memorandum of September 17, 1997, the Fire Prevention Division requires “copies of all inspection reports . . . to be submitted to [the Codes Enforcement section] on a monthly basis no later than the tenth (10<sup>th</sup>) day of the following month.” The memo lists the information the report must contain.

For 10 of 20 modular housing manufacturer files tested (50%), the Codes Enforcement section could not locate from 2 to 24 required monthly production reports per manufacturer. In these reports, the manufacturer is to list the state sequentially numbered labels attached to specific units—identified by the manufacturer’s serial number—that were produced during the month. Again, there was no evidence of follow-up requests for these reports. *Tennessee Code Annotated*, Section 68-126-304 (a)(1), states,

No modular building unit shall be offered for sale, sold, or installed in this state unless it is approved and bears the insignia of approval of the commissioner, the commissioner’s designee, or an approved inspection agency.

The monthly reporting form provided to manufacturers by the Codes Enforcement section states that the report “must be submitted on a monthly basis.” Per the *Rules of the Department of Commerce and Insurance*, Division of Fire Prevention, State Fire Marshal’s Office, Chapter 0780-2-13-.11,

The manufacturer shall keep permanent records of the handling of all labels. A copy of such records shall be sent to the department upon request. The records shall specify at least:

- (a) The number of labels attached to modular building units or components;
- (b) Each unit or component to which a label has been attached, and the serial number of such label;
- (c) The disposition of any damaged or rejected labels; and
- (d) The location and custody of all unused labels.

The purpose of the requirements for modular housing inspections and production reports is the protection of the tenants of these units. Because the Codes Enforcement section does not monitor the submission of monthly reports, there is increased risk that inspections required of the Department of Commerce and Insurance by state law are not being performed by the approved

construction inspection agencies. And, lacking adequate controls, the Codes Enforcement section cannot effectively track the Tennessee Modular Labels to the modular building units.

### **Recommendation**

Management should enforce the modular housing policies and procedures for the submission of monthly inspection reports and production reports by closely monitoring these reports, to ensure that (a) all modular building units manufactured in this state, or intended to be offered for sale, sold, or installed in this state are inspected and (b) the state can track the Tennessee Modular Labels to the modular building units.

### **Management's Comment**

We concur. This finding was due to the noncompliance of the third party inspection agencies to a memorandum issued by the Codes Enforcement Section. Management is currently reevaluating the policy regarding the monitoring of third party inspections. In order to facilitate compliance with departmental requirements and to ease the department's workload in reviewing the excessive volume of reports from third party inspection agencies, procedural changes are currently under development and should be in place within the next six months.

One hundred percent of the monthly production reports from modular housing manufacturing files have been reviewed and manufacturers have been notified of any missing or incomplete information. Responses are now being received from the manufacturers. We will continue to monitor this process until all files are complete and all of the state sequentially numbered labels are properly reconciled to the master list. Newly hired and trained clerical employees will be assigned to this duty to ensure that these forms are sorted, entered into the computer, and filed in a timely manner.

---

## **MANUFACTURED HOUSING**

The objectives of our review of the manufactured housing controls and procedures in the Codes Enforcement section of the Division of Fire Prevention were to determine the adequacy of the procedures to carry out the section's responsibilities for manufactured housing and whether the section follows its procedures.

We reviewed applicable laws and regulations to determine the Codes Enforcement section's responsibilities for manufactured housing. We interviewed key personnel to gain an understanding of the section's controls and procedures for manufactured housing. We reviewed supporting documentation for these controls and procedures. In addition, we performed testwork on a sample of manufactured housing manufacturer files.

We determined there is insufficient documentation of manufactured housing inspections to determine compliance with regulations, as discussed in finding 7.

**7. There is insufficient documentation of manufactured housing inspections to determine compliance with regulations**

**Finding**

The U.S. Housing and Urban Development (HUD) agency and the Codes Enforcement section in the state Division of Fire Prevention regulate manufactured housing (mobile home) production in Tennessee. HUD regulations require all manufactured home manufacturers to have a Production Inspection Primary Inspection Agency (IPIA). The State of Tennessee, as the IPIA for all manufactured home manufacturers in the state, is responsible for the inspection of these homes. State inspectors must be at all manufacturing plants year-round, but different inspectors rotate among the plants. The inspectors send monthly recap sheets with all inspection reports for the month to the Codes Enforcement office.

For three types of inspections listed on the monthly recap sheets, there was insufficient evidence that inspectors performed some of the required actions.

- A. In 10 of 25 manufacturer files tested (40%) there was no evidence that the inspector reviewed the quality assurance manual and the approved designs once a week. Per HUD regulations, every manufactured home in the manufacturing plant is to be inspected at least once in some phase of production with respect to the manufacturer's quality assurance manual and approved designs. The inspector fills out inspection reports for every production line visit made.

To ensure the inspector clearly understands and performs the inspection with respect to compliance with approved designs, Section C.5. of Codes Enforcement's manufactured housing procedures manual requires the inspector to review the quality assurance manual and approved designs at the beginning of each inspection visit and to study these at least once a week during the visit.

HUD's Manufactured Home Procedural and Enforcement Regulations, §3282.362(a)(1), states,

An IPIA . . . shall be responsible for assuring

- (i) That the plant is capable of following the quality control procedures set out in the quality assurance manual to be followed in that plant;
- (ii) That the plant continues to follow the quality assurance manual;
- (iii) That any part of any manufactured home that it actually inspects conforms with the design, or where the design is not specific with respect to an aspect of the standards, to the standards;



- (iv) That whenever it finds a manufactured home in production which fails to conform to the design or where the design is not specific, to the standards, the failure to conform is corrected before the manufactured home leaves the manufacturing plant; and
- (v) That if a failure to conform to the design, or where the design is not specific, to the standards, is found in one manufactured home, all other homes still in the plant which the IPIA's records or the records of the manufacturer indicate might not conform to the design or to standards are inspected and, if necessary, brought up to the standards before they leave the plant.

In addition, paragraph (c)(1) of the same section says,

The IPIA shall be responsible for conducting representative inspections to assure that the manufacturer is performing its quality control program pursuant to and consistent with its approved quality assurance manual and to assure that whatever part of a manufactured home is actually inspected by the IPIA is fully in conformance with the design and, as appropriate under paragraph (a)(1)(iii) of this section, with the standards before a label is issued for or placed on that manufactured home.

If the Codes Enforcement section does not enforce policies and procedures for the inspector's review of quality assurance manuals and approved designs, the inspector might not detect a nonconformance in a manufactured home. A nonconformance missed in one home could occur in many other homes, and would not be corrected before the manufacturing plant shipped the homes.

- B. In two of 25 manufacturer files tested (8%) there was no evidence on the monthly recap sheet that the inspector reviewed the manufacturer's label storage and recording procedures at least once a month. HUD requires the IPIA to provide the manufacturer with a two- to four-week supply of labels. The Codes Enforcement section's procedures manual (C.7.) requires the inspector to review for label control and labels on hand at least once a month.

Per §3282.362(c)(2)(ii)(E) of the HUD regulations,

Failure to maintain control of labels through the date the manufactured home leaves the manufacturing plant and failure to keep adequate records of which label is on which manufactured home shall render the IPIA subject to disqualification under §3282.356.

The failure of the section to follow its policies and procedures for the review of label control and labels on hand could result in the unlawful use of the labels; the use of labels that have been damaged, destroyed, or made illegible rather than being returned to HUD to be replaced with new labels; and the disqualification of Tennessee as the IPIA for manufactured homes in the state.

- C. In one of 25 manufacturer files tested (4%) there was no evidence on the monthly recap sheet that the inspector observed the manufacturer's test equipment. The Codes Enforcement section's procedures manual (C.3.a. and b.) requires the inspector to observe the condition of all test equipment at least once a month.

In addition, HUD regulations, §3282.362(c)(1), state,

As part of its function of assuring quality control, the IPIA shall inspect . . . test equipment used by the manufacturer at least once a month, and more frequently if unacceptable conditions are observed.

The failure of the section to follow HUD's and its own policies and procedures for the observance of the manufacturer's test equipment could result in unacceptable conditions not being detected.

### **Recommendation**

Management of the Codes Enforcement section should enforce policies and procedures for the inspection of manufactured homes, including a review of the inspection reports upon receipt to ensure they are completed in accordance with the section's manufactured housing policies and procedures.

### **Management's Comment**

We concur. Management instituted revisions to the monthly re-cap sheet that inspectors submit to ensure compliance with the requirements of the procedures manual. These revisions document the review of the quality assurance manual, the approved designs, manufacturer's label storage and recording procedures, and inspection of test equipment. Inspectors must initial that these reviews were completed in a timely manner. Additionally, the supervisors have been directed to review and initial each re-cap sheet to ensure compliance with HUD and departmental regulations.

---

## **MOTOR VEHICLE COMMISSION**

The objectives of our review of the controls and procedures for the Motor Vehicle Commission in the Division of Regulatory Boards were to determine the adequacy of the procedures to carry out the commission's responsibilities, and whether the commission follows its procedures.

We reviewed applicable laws and regulations to determine the commission's responsibilities. We interviewed key personnel to gain an understanding of the commission's controls and procedures for motor vehicles, and we reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of dealer, dismantler/recycler, and salesperson files.

We determined that the Motor Vehicle Commission is not in compliance with state law, as discussed in finding 8.

## **8. The Motor Vehicle Commission's policies are not in compliance with state law**

### **Finding**

Of the six motor vehicle dealer files selected and reviewed, one revealed a motor vehicle license had been issued to the dealer without sufficient evidence that a business tax license had been issued to the dealer. Further, the commission's policy is not as stated in the law.

Per Title 55, Chapter 17, of *Tennessee Code Annotated*, the Motor Vehicle Commission was created "to regulate and to license motor vehicle manufacturers, distributors, dealers, salespersons, and their representatives doing business in Tennessee in order to prevent frauds, impositions, and other abuses upon its citizens." The commission operates under this law and the *Rules of Tennessee Motor Vehicle Commission*.

The Motor Vehicle Commission sends a list of minimum requirements for the Tennessee Motor Vehicle Dealer License to those who wish to become dealers. Upon completion of the requirements, the applicant for the dealership is advised to contact the field investigator for the county, who performs an initial field inspection. If the field investigator determines that all requirements have been met, the commission is informed and issues a dealer license to the applicant.

Item 7 of the commission's Minimum Requirements for Tennessee Motor Vehicle Dealer License states,

A current business tax license issued by the County Clerk must be obtained prior to completion of the application process, or obtained immediately following the issuance of said motor vehicle license. The time of issuance of the business tax license is subject to the policy of the respective County Clerk.

However, per *Tennessee Code Annotated* §55-17-111(a), the commission shall require applicants,

as a condition precedent [emphasis added] to the issuance of a license, to provide such information . . . as the commission may deem necessary; provided,

that every application for a new dealer's license shall contain . . . (6) Evidence that the motor vehicle dealer applicant is the holder of a current business tax license indicating that the applicant's business is that of a motor vehicle dealer.

County clerks issue business tax licenses. This dealership did not have a business tax license number at the time of the initial field inspection because of its location in Shelby County, where the county clerk does not issue a business tax license number until the business is in operation. Furthermore, the next field inspection may not occur for up to two years, when it is a requirement for renewal of the two-year license. The commission made an exception for Shelby County, allowing the issuance of a motor vehicle dealer license without documentation or verification by the field investigator of the issuance of the county business tax license. Only two of Tennessee's 95 counties issue the business tax license on this delayed basis; a third county has no business tax license.

### **Recommendation**

The Motor Vehicle Commission should rewrite and enforce its policies and procedures to comply with state law.

### **Management's Comment**

We concur. We have revised the "Minimum Requirements" to reflect current state law. The requirements now state; "A current business tax license issued by the County Clerk must be obtained prior to completion of the application process in the name of the entity to be licensed." We have also corresponded with the respective county clerks' offices and they have agreed to reverse their policy to comply with state law, thereby enabling a business tax license to be issued prior to a dealer license being issued.

---

## **CONSUMER AFFAIRS**

The objectives of our review of the complaint resolution system in the Division of Consumer Affairs were to determine whether follow-up on complaints is done promptly, and whether procedures for complaint follow-up are adequate.

We interviewed key personnel to gain an understanding of the division's policies and procedures for resolving consumer complaints. We reviewed supporting documentation for these controls and procedures. In addition, we performed testwork on a sample of complaints.

We determined that the Division of Consumer Affairs does not comply with its procedures for requesting a written reply to complaints from the respondent, as discussed in finding 9.

**9. The Division of Consumer Affairs does not comply with its procedures for timely follow-up with complaint respondents**

**Finding**

The mission of the Division of Consumer Affairs is to serve and protect consumers from deceptive business practices through the processes of mediation, education, investigation, litigation, legislation, and registration. The division receives between 5,000 and 7,000 complaints every year. When a complaint is received, the division mails a postcard to the complainant acknowledging receipt of the complaint and advising that it will attempt to get a response. The division creates a file for every written complaint it receives and divides the complaints by category among seven consumer protection specialists. The specialists attempt to mediate a successful outcome for each complainant by contacting the respondent (the entity or individual against whom the complaint is made).

The Consumer Affairs *Employee Procedures Manual* requires the first letter to the respondent be sent no more than five working days after the complaint file is created. In 6 of 31 complaint files tested (19%), the first letter to the respondent was sent from 2 to 80 days late. For two complaints, the computer data base did not contain documentation of the date the complaint file was created; consequently, it could not be determined whether the first letter to the respondent was sent within five working days.

The division's procedures manual requires the specialist to send a second letter to the respondent, by certified mail, within 10 to 15 business days if no reply to the first letter has been received. In one of nine complaint files tested (11%), the second letter to the respondent was sent 22 days late.

The failure of the Consumer Affairs Division to adhere to its policies and procedures for timely follow-up with respondents may cause a lengthy wait for a consumer to receive a reply, thus delaying resolution of the complaint.

**Recommendation**

Since the mission of the Division of Consumer Affairs is to serve and protect consumers, it is very important that the division adhere to its policies and procedures for responding to and resolving consumer complaints promptly.

## Management's Comment

We concur. The Division has instituted a follow-up report that is generated each morning when the Consumer Protection Specialist logs into the Complaint Management Systems. This report must be completed before the CPS proceeds further. Management has also reviewed the policies with all Consumer Protection Specialists and relayed the importance of adherence to these policies.

---

## ANNUAL REPORT

*Tennessee Code Annotated* requires each state agency to submit a written report to the Governor concerning the agency's functions, management, and financial transactions of the agency for the preceding fiscal year. The objective of our review of the department's annual report was to determine whether the report had been submitted in compliance with the statute.

We interviewed key departmental personnel to gain an understanding of the department's procedures for the preparation and submission of the annual report to the Governor. The department prepared the annual report for 1998 on the basis of the calendar year rather than the fiscal year, and as of the end of our fieldwork May 17, 2000, had not issued the report for the fiscal year ended June 30, 1999, as discussed in finding 10.

### **10. The department did not submit its annual report in compliance with state law**

#### Finding

The Department of Commerce and Insurance did not prepare and submit its annual report in compliance with state law. The department prepared an annual report for calendar year 1998 and submitted it to the Governor August 15, 1999. No report for the fiscal year ended June 30, 1999, has been issued. Section 4-4-114(a)(1), *Tennessee Code Annotated*, states:

The head of each administrative department, established by chapter 3 of this title, and the state treasurer, the secretary of state, and the adjutant general, unless otherwise provided in this title, shall annually, on or before October 1, report in writing to the governor concerning the functions, management and financial transactions of such person's department or agency for the preceding fiscal year. (Effective January 20, 1943)

Without timely reporting, the information in the annual report to the Governor concerning the department's functions, management, and financial transactions during the preceding fiscal year loses its significance and becomes irrelevant in decision-making.

## **Recommendation**

The department should issue an annual report to the Governor for each fiscal year ending June 30 on or before October 1 of that year, as required by state statute.

## **Management's Comment**

We concur. Although the department has not submitted the currently required report in a timely manner, procedures have been implemented to ensure that all future annual reports to the Governor contain relevant information and are submitted in a timely manner in accordance with state law.

---

### **ARSON**

The objectives of our review of the controls and procedures for the Arson section in the Division of Fire Prevention were to determine the adequacy of the procedures to carry out the section's responsibilities, and whether the section follows its procedures.

We reviewed applicable laws and regulations to determine the Arson section's responsibilities. We interviewed key personnel to gain an understanding of the section's controls and procedures over arson investigations, and we reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of investigation files to determine if there was evidence the investigation was begun promptly and whether there was adequate documentation of the investigation.

We had no findings related to the Arson section; however, other minor weaknesses came to our attention that have been reported to management in a separate letter.

---

### **INSURANCE**

The objectives of our review of the controls and procedures for the Actuarial and Rating sections of the Division of Insurance were to determine

- the adequacy of each section's procedures to carry out its responsibilities,
- whether each section follows its procedures, and
- the qualifications of insurance examiners.

We reviewed applicable laws and regulations to determine the Actuarial and Ratings sections' responsibilities. We interviewed key personnel to gain an understanding of the division's controls and procedures over actuarial files, rating files, and qualifications of insurance examiners. We reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of actuarial files and rating files; the files of all insurance examiners in the company examinations section were reviewed.

We had no findings related to the Actuarial and Rating sections of the Division of Insurance.

---

## **TENNCARE OVERSIGHT**

The objectives of our review of the Division of TennCare Oversight were to determine

- the adequacy of the division's procedures to carry out its responsibilities,
- whether the division follows its procedures, and
- the qualifications of the division's auditors.

We reviewed applicable laws and regulations to determine the Division of TennCare Oversight's responsibilities. We interviewed key personnel to gain an understanding of the division's controls and procedures, and we reviewed supporting documentation for these controls and procedures. In addition, we examined all desk reviews conducted from July 1, 1997, through June 30, 1999, for managed care organizations and behavioral health organizations to determine if these reviews were conducted timely and if these organizations' quarterly reports had been reviewed for compliance with minimum net worth requirements and compliance with restricted deposit requirements. We examined files of all TennCare Oversight auditors to determine if educational and/or experience requirements established by the Department of Personnel were met, if the auditors participate in continuing education courses, and if there is a sufficient oversight audit staff in the department.

We had no findings related to the Division of TennCare Oversight.

---

## **TRAVEL**

The objectives of our review of the controls and procedures for travel were to determine whether controls and procedures for travel are adequate, and whether all payments for travel have been paid in accordance with the state's Comprehensive Travel Regulations.

We interviewed key personnel to gain an understanding of the department's controls and procedures over travel and reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of travel expenditures to determine if travel claims and supporting documents complied with travel regulations.

We had no findings related to travel.



---

## **CONTRACTS**

The objectives of our review of the controls and procedures for contracts were to determine whether contracts have been made in accordance with regulations, contract payments are in compliance with contract terms and purchasing guidelines, and contract payments are properly approved and recorded against the contract.

We interviewed key personnel to gain an understanding of the department's controls and procedures over contracts and reviewed supporting documentation for these controls and procedures. In addition, testwork was performed on a sample of contracts and related payments.

We had no findings related to contracts.

---

## **BOARD OF ACCOUNTANCY**

The objectives of our review of the controls and procedures for the Board of Accountancy in the Division of Regulatory Boards were to determine the adequacy of the board's procedures to carry out its responsibilities and whether the board follows its procedures.

We reviewed applicable laws and regulations to determine the Board of Accountancy's responsibilities. We interviewed key personnel to gain an understanding of the board's controls and procedures. We reviewed supporting documentation for these controls and procedures. In addition, we performed testwork on a sample of files to determine compliance with state law in license issuance/renewal for applicants for the CPA certification, renewal of the CPA certificate, applications for firm practice permits, and renewal of firm practice permits.

We had no findings related to the Board of Accountancy.

---

## **FINANCIAL INTEGRITY ACT**

The Financial Integrity Act of 1983 requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30, 1999, and each year thereafter. In addition, the head of each executive agency is also required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

The objectives of our review of the Department of Commerce and Insurance's compliance with the Financial Integrity Act were to determine whether

- the department's June 30, 1999, responsibility letter and December 31, 1999, internal accounting and administrative control report were filed in compliance with the Financial Integrity Act of 1983;
- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained;
- procedures used in compiling information for the internal accounting and administrative control report were adequate; and
- corrective actions have been implemented for weaknesses identified in the report.

We interviewed key employees responsible for compiling information for the December 31, 1999, internal accounting and administrative control report submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to gain an understanding of the department's procedures. We also reviewed the supporting documentation for these procedures.

We determined that the Financial Integrity Act responsibility letter and internal accounting and administrative control report were submitted on time, and support for the internal accounting and administrative control report was adequate.

---

## **PRIOR AUDIT FINDINGS**

---

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Commerce and Insurance filed its report with the Department of Audit on September 30, 1999. A follow-up of all prior audit findings was conducted as part of the current audit.

The current audit disclosed that the Department of Commerce and Insurance has corrected previous audit findings concerning electrical inspection procedures, misappropriation of funds by an issuing agent, inadequate monitoring of cemetery companies, and inadequate refunding policies and procedures and records of pending matters of the insurance agent licensing section.

---

## OBSERVATIONS AND COMMENTS

---

### **TITLE VI OF THE CIVIL RIGHTS ACT OF 1964**

*Tennessee Code Annotated*, Section 4-21-901, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. The Department of Commerce and Insurance filed its compliance report and implementation plan on June 22, 1998, and June 24, 1999.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

On October 15, 1998, the commissioner of Finance and Administration notified all cabinet officers and agency heads that the Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

### **TITLE IX OF THE EDUCATION AMENDMENTS OF 1972**

*Tennessee Code Annotated*, Section 4-4-123, requires each state governmental entity subject to the requirements of Title IX of the Education Amendments of 1972 to submit an annual Title IX compliance report and implementation plan to the Department of Audit by June 30, 1999, and each June 30 thereafter. The Department of Commerce and Insurance did not file its compliance report and implementation plan by June 30, 1999, in violation of this statutory requirement. The Department of Commerce and Insurance should produce a plan stating how it intends to comply with Title IX.

Title IX of the Education Amendments of 1972 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no one receiving benefits under a federally funded education program and activity is discriminated against on the basis of gender. The untimely filing of the compliance report and implementation plan required by state law does not necessarily mean that the Department of Commerce and Insurance is not in compliance with federal law.

---

## APPENDIX

---

### DIVISIONS AND ALLOTMENT CODES

Department of Commerce and Insurance divisions and allotment codes:

335.01	Division of Administration
335.02	Division of Insurance
335.03	Division of Fire Prevention
335.04	Division of TennCare Oversight
335.05	Division of Securities
335.06	Division of Consumer Affairs
335.08	911 Emergency Communications*
335.09	Tennessee Racing Commission**
335.10	Division of Regulatory Boards
335.15	Real Estate Education and Recovery
335.16	Auctioneer Education and Recovery
335.17	Tennessee Board of Pharmacy***
335.27	Tennessee Motor Vehicle Commission***
335.28	Tennessee Commission on Fire Fighting Personnel
335.30	Tennessee Claims Commission**

\* Added in 1999

\*\* Abolished after 1998

\*\*\*Moved into Division of Regulatory Boards in 1999